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PASS TREASURY FOR OASIA/ICB/PETER MAIER
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SUBJECT: Austria?s 2009/2010 Budgets: Fat Now, Lean to Come

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Sensitive but unclassified -- protect accordingly.

¶1. (U) SUMMARY: On May 29, Austria?s Parliament adopted budgets for 2009 and 2010, endorsing a temporary flood of red ink to mitigate the current economic downturn. Total public sector deficits will likely exceed 4.0%/GDP in 2009 and 5.0% in 2010 (versus the GoA?s estimates of 3.5% and 4.7% respectively, which are based on outdated forecasts). The GoA?s forecast for public debt (73%/GDP at the end of 2010) is also too optimistic: the debt ratio could be closer to 80%/GDP by the end of next year. This cable provides a detailed analysis of expenditures, including defense (which will fall) and social welfare (which will grow substantially). END SUMMARY.

Budget Overview
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¶2. (U) On May 29, Parliament approved the GoA?s 2009 and 2010 budget bills (ref A) with support from the government coalition parties, the Social Democrats (SPO) and the People?s Party (OVP), and over the opposition of all other parties (the Greens, the Freedom Party (FPO) and the Alliance for the Future of Austria (BZO)). The 2009 budget shows nominal expenditures of EUR 77.5 billion ($108.5 billion at the current exchange rate of $1.40/EUR) and revenues of EUR 63.9 billion ($89.4 billion). Net of asset swaps, i.e. EUR 6 billion ($8.4 billion) in revenues from dissolution of reserves and EUR 9.3 billion ($13.0 billion) in expenditures for equity participations in banks, the relevant federal deficit pursuant to EMU Maastricht criteria is EUR 9.0 billion ($12.6 billion) or 3.2%/GDP.

¶3. (U) The figures for 2010: expenditures of EUR 70.8 billion ($99.1 billion), revenues of EUR 57.6 billion ($80.6 billion), and a Maastricht deficit of EUR 11.6 billion ($16.2 billion) or 4.1%/GDP.

¶4. (U) The benchmark for international comparisons is the total public sector deficit (encompassing all levels of government, according to the EMU?s Maastricht definition). A 2008 agreement requires provincial governments and other public bodies to render a surplus of 0.5%/GDP annually to offset some of the federal deficit, but due to the economic crisis those bodies will also run a deficit estimated at 0.3-0.6%/GDP. In sum, the GoA projects the total public sector deficit to reach 3.5%/GDP in 2009 and 4.7%/GDP in 2010, and says consolidated public sector debt will reach 68.5%/GDP by the end of 2009 and 73%/GDP by the end of 2010, with the federal government accounting for more than 90% of the debt. COMMENT: as detailed below, those estimates are far too optimistic -- END COMMENT.

Price Tag for Fiscal Stimulus
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¶5. (U) Crisis spending, tax cuts, and automatic stabilizers will drive up deficits sharply. While the EUR 100 billion bank rescue package has had a limited budgetary impact so far, other crisis

measures are have an immediate impact on the budgets, mostly in 2009 but some also in 2010. These include:

-- the first economic stimulus package in late fall 2008, with infrastructure measures for railroads and road construction and subsidies, loans, and guarantees for SMEs,

-- the second economic stimulus package, which moves forward GoA building investments, accelerates depreciation of tangible assets, give subsidies for thermal retrofitting of buildings, additional R&D funds, and funds an obligatory free Kindergarten year for pre-school kids.

-- an income tax cut (retroactive to January 1) valued at EUR 2.3 billion, increased family payments of EUR 0.5 billion, and measures for the self-employed costing EUR 0.3 billion. As a result, half of Austrian wage earners no longer pay income tax.

-- an EUR 220 million labor market package with measures to support employment and training and finance reduced-work arrangements.

-- the ?cost-of-living? measures Parliament enacted before September 2008 elections, including a thirteenth monthly family allowance, a higher nursing care allowance, the abolition of university student fees, an extension (from 2010 to 2013) of the possibility for early retirement without cuts in pension payments, and a VAT cut on pharmaceuticals from 20% to 10% -- altogether costing over EUR 1.5 billion annually (ref D).

Political Debate over Budgets
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¶6. (U) Defending the budget in Parliament, Finance Minister Josef Proell painted the 2009/10 budgets as a decisive reaction to the financial and economic crises. With a bank rescue package to stabilize credit markets, fiscal stimulus for investment and industry, and the income tax cut to strengthen private consumption, Proell explicitly endorsed temporarily higher deficits, but called on all levels of government to prepare for administrative reforms and cut-backs.

¶7. (U) The opposition predictably panned the budgets. Far-right FPO head Heinz-Christian Strache criticized the income tax cut as too small. BZO (also far-right) Chairman Josef Bucher accused the GoA of ?flying blind? on budgets and stalling on reforms, and predicted a ?crash landing.? Green party chairwoman Eva Glawischnig accused the GoA of exacerbating poverty and misery by not increasing unemployment benefits and emergency welfare payments.

Line Item Highlights
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¶8. (SBU) GUARANTEES: GoA guarantees for various purposes stand at EUR 104 billion ($145.6 billion) at the end of 2008 (2007: EUR 80 billion). The sharp increase in 2008 was primarily due to higher demand for export financing guarantees and guarantees for interbank lending and bond issues under the new bank rescue package (ref C). Those effects will continue and grow with the GoA?s economic stimulus guarantees -- the level of outstanding guarantees will rise further in 2009 and 2010 -- as will GoA outlays to cover more failures.

¶9. (SBU) DEFENSE: The MoD?s funding level in 2009 will be EUR 2.112 billion. While this is a nominal 3.6% increase from 2008 budgeted levels, in fact it represents a decline of 2.8% (EUR 61 million) from the actual spending level in 2008. Defense expenditures will comprise around 2.7% of 2009 budget expenditures or 0.75%/GDP (down from 2008 actual spending of 0.77%/GDP). For 2010, the defense budget is essentially flat (EUR 2.122 billion, an increase of EUR 12 million or 0.57%). Defense will take a slightly larger share of falling total budget expenditures in 2010 (3%), but stagnate in terms of GDP (0.75%). At that level, MoD funding is rock bottom and far from the 1.0%/GDP level the Armed Forces Reform (Bundesheer) Commission in 2004 stated was required to adequately fund the

Bundesheer's reform program.

¶10. (U) EU Contributions: The 2009 budget includes EUR 2.2 billion (2010: EUR 2.4 billion) in EU contributions versus expected EU payments of EUR 1.8 billion (2010: EUR 1.8 billion), amounting to a net contribution of approximately EUR 361 million (2010: EUR 613 million).

¶11. (U) Civil Service: The GoA will make only minimal cuts to civil service jobs. Excluding employees of the federal railroads, postal company and other entities, the GoA has some 136,500 civil service jobs. Expenditures for active personnel will total EUR 10.7 billion in both 2009 and 2010 (including transfers to provincial governments for the salaries of 67,500 teachers). Pension expenses for the growing ranks of civil service retirees will be about EUR 4.3 billion annually or EUR 7.4 billion including railroad and postal retirees. Thus, total GoA personnel expenditures for active and retired civil service employees (including outsourced and refunds) will be around EUR 18.1 billion per year, equal to 23% of total budget expenditures in 2009 and 26% in 2010.

¶12. (U) Pensions and Social Affairs: Excluding civil service pension expenses, GoA contributions to the social insurance system for pensions should rise to EUR 7.3 billion in 2009 from EUR 6.6 billion in 2008, and further to EUR 7.8 billion in 2010. For labor market programs and unemployment benefits, the budget includes EUR 6.0 billion in 2009 and EUR 6.4 billion in 2010, and for family allowances and nursing benefits EUR 8.0 billion in 2009 and EUR 8.4 billion in 2010. Including minor amounts for other programs, the GoA?s total social services expenditures, excluding civil service expenses, will be EUR 23.1 billion in 2009 and EUR 24.6 billion in 2010 (2008: EUR 21.3 billion). In addition the GoA will spend about EUR 1.0 billion annually for health services and hospitals.

COMMENT
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¶13. (SBU) Austria?s public deficits will be an order of magnitude higher than in 2008 (0.6% and 0.4%, respectively) and well over the 3%/GDP reference value for Euro-zone economies. Local economists support the current stimulus, but are concerned that the GoA has failed to update its projections. The budgets are based on outdated growth projections of -2.2% in 2009 and 0.5% growth in 2010 (and unemployment rates of 5.0% and 5.3%, respectively). Current forecasts see a deeper and longer recession: the European Commission sees -4.0% in 2009 and stagnation in 2010, while Austria?s central bank forecasts -4.2% in 2009 and -0.4% in 2010 (with unemployment

rates of 5.3% and 6.5%, respectively). Bernhard Felderer (Head of the Federal Debt Commission) has said Austria?s debt ratio (58.4%/GDP in 2008) could easily reach 80%/GDP by 2013 while GoA annual interest payments will top EUR 10 billion (versus EUR 7.5 billion in 2008). Felderer and others want the GoA to announce decisive spending cuts to return the debt level to 60%/GDP within the next five to ten years, since revenue increases will be problematic.

¶14. (SBU) While pre-election giveaways in late 2008 softened the initial crisis impact, they do nothing for long-term recovery or productivity. The GoA enjoys broad approval for its decisive economic stimulus and bank rescue efforts, but the real test will start in late 2010, when FinMin Proell will have to cut deficits dramatically and try to stop the debt ratio?s rise. 2011 will be particularly trying, since elections will loom larger on the horizon (parliamentary elections will be in fall 2013 at the latest). Austria?s grand coalition, which quickly united on new spending, will face tremendous divisions over budget consolidation since the SPO tends to favor new/higher taxes while the OVP leans towards cutting expenditures -- and unemployment will be higher than today. In such a trying climate, Austria?s growing opposition parties may grow further.

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